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SUBJECT: Argentina's auto sector still somewhat strong despite financial crisis

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Summary

¶1. (U) The Argentine auto sector is on track for another record-breaking year in 2008, in spite of the adverse impact of the global financial crisis on the Argentine economy and recent high profile media reports of slowdowns in sales and planned layoffs. Production, sales, and exports are at all-time highs as the auto sector appears set to record yet another strong year in its remarkable, six-year recovery since the 2001-02 economic crisis. The sector, in which Ford and General Motors are key players, is a centerpiece of Argentina's industrial base, with significant future investment planned. While a recently-updated Mercosur auto trade pact with Brazil further consolidates Argentina's already-strong auto production, integration, and export ties with its giant neighbor, the GoA's current priority is to promote its still-fledgling auto parts sector. Like the rest of the industrial sector, the auto sector's competitiveness challenges include inflation, energy, high labor costs, and infrastructure bottlenecks. And while the global financial crisis has increased fears of softening domestic production, sales, exports, and job security, industry analysts point out that the industry is better positioned than it was during the last economic crisis in 2002 due a stronger domestic consumer base and greater export diversification, and industry prospects are still generally positive. END SUMMARY.

2008 still on track for another record year

¶2. (U) Despite the largely negative impact the global financial crisis is having on the Argentine economy (septels), the Argentine auto sector is enjoying a record year, and continues its starring role as the key driver of Argentina's industrial expansion. Auto production, sales, and exports continue their strong, post-crisis recovery. 2007 was an all-time record in terms of production, exports, imports, and new and used car sales, and a still-relatively strong economy appears set to propel the sector to an even better year in 2008. The Argentine auto producer association, Adefa, in a recent report, estimates that the 2007 all-time records for production (545,000), exports (316,000, 58% of production), imports (365,000), and domestic sales (565,000) will be exceeded in 2008 with 600,000 units produced, 340,000 exported, and 610,000 cars sold domestically. In addition, the estimate of 1.65 million used car sales easily surpasses the 2007 used car sales record of 1.4 million units.

¶3. (U) Argentina is now the 24th largest auto producer in the world. Currently, almost 60% of all cars produced are exported, of which about 60% are sent to Brazil. Argentina has moved to diversify its export markets and reduce its over-dependence on Brazil, cutting the percentage of its exports to Brazil from an all-time high of 81% of total autos exported in 1998 to about 60% today. Argentina also has auto trade pacts with Mexico, Venezuela, and Chile, among others, an important factor in its auto export diversification strategy, and it now exports to 140 nations.

¶4. (U) Ford and GM, both with nearly 100 years of presence in Argentina, are among Argentina's top producers and exporters. Together, they accounted for 34% of 2008 production and about 58% of exports through September. Since 2006, Peugeot-Citroen has been the top single producer, followed by GM, Ford, Toyota, Renault, and VW. Domestic sales are led by VW, followed by GM, Peugeot-Citroen, Ford, Renault, Fiat, Toyota, and Daimler-Chrysler.

Crown jewel of Argentina's industrial base

¶5. (U) The auto sector provides well-paying and high-skilled jobs, technology transfer, and is an important multiplier in the industrial chain. The industry had a 2007 turnover of about $15 billion, almost 6% of GDP. It employs about 121,000, plus several times that number in indirect jobs. The sector accounts for about 20% of industrial production, 36% of industrial exports, and 36% of industrial growth. Argentina's industrial output grew by 7.5% in 2007, mainly driven by the auto sector's 25.4% growth. Capacity utilization remains comparatively low, at about 58.3% through July 2008, below the average of 73.0% for the industrial sector as a whole. Given these figures, it is not surprising that the sector is of great political importance, and one that the GOA strongly promotes.

¶6. (SBU) Car companies have built a good relationship with high-ranking officials in the Kirchner administration - a major asset in a country where decisions are generally concentrated among a handful of people. Under President Cristina Fernandez de Kirchner's (CFK) administration, former Peugeot-Citroen president Luis Ureta Saenz Pena was named GOA's ambassador to France, while Fiat truck maker Iveco's President, Fernando Fraguio, was named Industry Secretary.

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Investment of $3.5 billion over next three years
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¶7. (U) Auto makers have announced investments for new models and/or increased capacity of about $3.5 billion for the 2008-2010 period, according to the local car makers association Adefa. This is well above the $562 million invested in 2002-04 and $1.5 billion in 2005-07. (The financial crisis could cause some of these plans to be scaled back, but not scrapped completely, according to industry sources.) Companies have also begun production or unveiled plans to produce at least six new models in 2008-09 alone, nearly as many as were launched in 2002-07, and to manufacture gears and engines. New capacity expansions have been announced by VW ($320 million), Peugeot ($700 million), GM ($600 million), Ford ($500 million), Fiat ($420 million), Honda ($300 million), Renault ($200 million), and Fiat's truck division Iveco ($150 million). Honda will start local production in 2009, marking the first entry of a major manufacturer in the car sector in over ten years. Honda expects to produce 30,000 compact cars per year, roughly 60% of which will be exported to Brazil.

New Mercosur managed trade accord, 2008-2013

¶8. (SBU) In June 2008, Brazil and Argentina signed a five-year extension to their Mercosur managed auto trade regime, the fifth such accord (ref C). Argentina-Brazil auto trade currently constitutes about 18% of total intra-Mercosur trade, and totaled over $4 billion in 2007. Total Argentine and Brazilian production

is projected by the industry chamber Adefa to be six million autos per year by 2013, which would make the two countries combined the fourth-largest auto producer in the world, after the United States, Japan, and China. About 4.9 million units would be produced in Brazil, and about 1.1 million in Argentina (almost double Argentina's output today).

¶9. (SBU) Despite an expectation by some analysts that Argentina would agree to free trade in autos, this latest accord effectively extended the managed trade system further. GOA officials have long voiced concern about the asymmetries they see in the relative competitiveness of Argentine and Brazil auto production, due to the latter's much larger domestic market (about four times Argentina's), scales of production (about five times Argentina's), broader consumer base (and consequent ability to sustain new car models), and its longstanding promotion of industrial development with subsidies and incentives from national, state, and local governments. Brazil's share of the Argentine auto market also dwarfs Argentina's market share in Brazil. Industries Secretary Fernando Fraguio told EconCouns in June 2008 that bilateral free trade in autos was not acceptable, noting that Argentina has a significant bilateral auto and parts trade deficit with both Brazil and Europe. "I believe in free markets and all, but the political reality is that Argentina's industrial policy is - and should be - geared to creating jobs."

¶10. (SBU) Completely free auto trade between Argentina and Brazil was again put off by Argentina, and will not begin until 2013 at the earliest. Under the 2008-2013 accord, for each $100 of exports Brazil sells to Argentina, Argentina may ship up to $250 worth of vehicles and auto parts back to Brazil. And for each $100 of Argentine exports, the Brazilian auto industry can ship up to $195 to Argentina. (Under the previous agreement, for the export of every $100 to the other country allowed the partner to import up to $195.) According to the trade publication "Just-auto," Brazil heard Argentina's complaints about possible free trade with its larger and more competitive partner (Brazil), and the need for Argentina to have more time to attract investments and devise strategies to counter any move toward more liberal and competitive trade after
¶2013. Producers (including U.S. car makers) support the Mercosur auto regime and claim they have adjusted well to it, that it has provided predictability and consistent rules -- an anchor of sorts

-- in a nation often seen as lacking in those areas. This success has in turn ensured continued political support for the auto pact, in a country where trust in the free market is often lacking. With the failure of the Doha round, Brazil and Argentine automaker groups Anfavea and Adefa have teamed up to propose an action plan in the hope of agreeing on a series of new automotive bilateral trade accords. Apart from a long-pending Mercosur trade agreement with the European Union, Anfavea and Adefa are also looking into possible deals with South Africa, Nigeria, Egypt, Indonesia, and Thailand, among others.

Auto parts: Argentina's next push

¶11. (SBU) The GOA's next auto-related push is to help out its own local auto parts industry, as it seeks to wean local manufacturers from its heavy dependence on mostly Brazilian parts. According to the consultancy group abeceb.com, Brazil supplies more than 50% of auto parts used to manufacture cars in Argentina. The bilateral auto pact called for the promotion of the parts industry, and the two sides pledged to discuss the possibility that the Brazilian Economic and Social Development Bank (BNDES) might help finance the establishment of Brazilian and Argentine auto parts plants in Argentina. In addition, the Argentine Congress recently passed a national auto parts promotion plan, with measures that include long-term credit at competitive rates and GOA rebates to local manufacturers that source local parts. GOA Industries Secretary Fraguio recently said that "we want cars produced in Argentina to be manufactured with more local parts." Argentina car parts association Afac President Rodolfo Achille said that "the objective is that, in two to three years, up to 70% of auto parts used in Argentina will be produced locally."

¶12. (SBU) While Argentina is already a relatively strong auto parts

producer, Argentine producers' competitiveness has been squeezed by high wages and high prices for imported primary inputs. Producers are still expected to invest $500 million in the next three years to keep up with demand from their main clients in Mercosur and other emerging markets, but in the first half of 2008, Argentina had a car parts deficit of $2.0 billion.

¶13. (SBU) According to Dante Sica, Director of abeceb.com, and a former Secretary of Industry, the point of the GOA's auto parts promotion is "not about competing with Brazil, but about the GOA trying to find solutions to remove bottlenecks in the industry. One of these (solutions) is boosting local parts production." With so many Argentine cars using Brazilian parts, and around 35% of all cars made in Argentina being sent to Brazil, Sica believes there is a strong case for more local parts production, to minimize the back-and-forth of cars and parts.

Challenges to competitiveness

¶14. (SBU) Auto manufacturers and analysts widely agree on the major challenges facing the sector, which are largely similar to those facing the rest of the industrial sector: inflation and frequent labor demands for higher wages, both which hurt competitiveness; energy shortages; transport bottlenecks; and expectations of slowing domestic demand, as the economy cools from its blistering pace of over 8.5% real growth per year, 2003-2007, to between 4-7% for 2008, and lower growth in 2009. Annual wage increases are now running at a minimum of 20%, and the union representing the auto workers, Smata, has publicly called for much higher increases. Regional and global inflation pressures are also reflected in higher prices for parts, transport and energy. Companies claim their production costs in dollar terms are now higher than in the 1990s.

¶15. (SBU) Energy shortages, especially during peak seasonal times, have forced most companies to incorporate energy conservation programs and engineer more costly solutions, including self-production via high-cost diesel generators, rotating shifts, forced worker leave, and sometimes switching production to the more expensive night shift. Transport and infrastructure bottlenecks are also a concern. Analysts widely cite the challenge and costs inherent in Argentina and Brazil's high volume, cross-border trade in autos and parts, over an already congested road, rail and river transport system. "While all this back and forth of parts and finished products between the two nations is all part of the Mercosur trade regime we all support, it is not exactly a great business model," said the CFO of General Motors Argentina.

¶16. (SBU) While access to consumer credit has been crucial for

domestic sales expansion (the stock of car financing loans rose 60% in 2007 and a similar increase is expected in 2008), and the share of cars sold on credit has risen in 2008 to about 25%-30%, this is still far from the 70% peak in the late 1990s. (The still relatively low purchasing power and limited access to credit in the Argentine market have boosted sales of second-hand units.) Ironically, since such a small amount of sales are done via credit, the sector could be less vulnerable to the effects of the global financial scare.

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While the current financial crisis clouds the scenario . . .
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¶17. (SBU) Even before the onset of the current global crisis, a slight slowdown in auto production, sales, and exports had been detected. While first-half 2008 figures were strong, the July-September period revealed a slight slowdown (but still up from the same period in 2007), and analysts were already predicting a weaker fourth quarter. According to anecdotal evidence, until early 2008, car buyers had to wait up to three months for delivery of many models. Now, there is plenty of stock. The crisis has worsened this outlook in the last couple of weeks, in Argentina and Brazil, and some analysts fear that consumers will pull back, affecting sales and exports.

¶18. (SBU) Brazil's Banco UBS Pactual said in a recent report that

"Argentine automobile production has decelerated at a rapid pace to the point that auto companies have reduced production plans for the fourth quarter by half and auto parts companies have announced layoffs." (Embassy has not been able to confirm any layoffs so far, but the local the local press widely carries reports of cuts in the auto parts sector.) It also noted that the recent weakening of Argentina's key trading partners' currencies, primarily Brazil's, will make domestic production relatively less competitive. For example, from its low on August 7 to October 17, the Argentine peso appreciated about 22% against main trading partner Brazil's real. "The auto industry is very worried because we see a future quite different from what we'd like to see," Dante Alvarez, president of auto dealer association Acara, which foresees declining sales for the next months. Several automakers, including GM, Fiat, Mercedes, Iveco, and Peugeot have announced worker holidays of one to five days, or shift reductions in the coming weeks. Others are reported to be considering outright furloughs for up to several hundred workers.

¶19. (SBU) Ford Argentina's President Enrique Alemany said the three pillars that had until now made 2008 a "spectacular year" - the sector's integration with the world, strong domestic growth, and competitiveness - are now being challenged. He said that "there is no more space in the automotive sector to allow increases in costs that are not accompanied by improvements in productivity." All this comes amidst tough ongoing wage negotiations for some automakers, including GM and Peugeot, and in which the main auto workers union (Smata) initially demanded a 65% wage increase. GM's CFO told Emboff that Smata's demand was more of an "opening bid," and some media reports note that the two sides could eventually settle at around a 20% increase. (These same media reports note that the situation has changed enough that some workers will now be content to just keep their jobs.)

Others remain guardedly optimistic

¶20. (SBU) Many auto players and analysts remain cautiously optimistic. While acknowledging that the remarkable six-year-long auto sector growth streak has likely peaked, they point out that the industry is much better positioned than it was during the last economic crisis in 2002. It is more internationally export-oriented and less dependent on Brazil, with many more auto trade agreements (including with Mexico, Venezuela, and Chile), investments, and a larger consumer base. These analysts point out that 2008 is still on schedule to be the all-time record year for production, new and used car sales, and exports. The industry's early 2008 goal for total production of 600,000 and sales of 620,000, if not quite achieved, will certainly come in at nearly those levels. Through September 2008, production, sales and exports were up 24%, 18%, and 23% over the same period in 2007.

¶21. (SBU) Ford Argentina's President Enrique Alemany predicted that the downturn would be short-lived. "I believe that the positive trend in the long term is still valid," he said. "We will see the impact of this financial crisis in the short term - that is, the next three to four months." Ford's local CFO told Emboff that as of

now, they are "cutting production a bit, but not laying anyone off," and otherwise not making any changes, and "we are still in the wait-and-see mode." He said that while they see signs of slightly lower sales and lower consumer confidence here and in Brazil (over half of Ford's production goes to Brazil), "I still see things going pretty well in Argentina." The local GM CFO told Emboff that while the economic situation is "worrisome, and while Brazil and Argentina sales are suffering right now (GM Argentina also exports over 50% of its production to Brazil)," overall he is "optimistic, and the industry is still reasonably strong. 2009 will likely see an overall market softening here, but I don't think it will be bad."

Comment

¶22. (SBU) While the outlook for Argentina's economy appears to be deteriorating (Ref A and septels), auto industry analysts are relatively upbeat. The sector is clearly better positioned to

weather an economic storm than it was during the 2002 economic crisis due a stronger domestic consumer base and greater export diversification. One's view of the sector also greatly depends on one's expectations: compared to the high hopes of the last few (record-breaking) years, the latest developments could be seen as a disturbing. However, the fact remains that Argentina's auto sector is still enjoying another record year, and is the nation's industrial leader.

WAYNE